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MEMORANDUM

TO: Docket Control

FROM: *for* Thomas M. Broderick
Director
Utilities Division

Approved

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AZ CORP COMMISSION
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2016 FEB 2 PM 3 05

DATE: February 2, 2016

RE: IN THE MATTER OF THE APPLICATION OF X5 OPCO LLC FOR A
CERTIFICATE OF CONVENIENCE & NECESSITY TO PROVIDE
COMPETITIVE INTEREXCHANGE TELECOMMUNICATIONS
THROUGHOUT THE STATE OF ARIZONA. (DOCKET NO. T-20946A-15-
0384)

Attached is the Staff Report for the above Application requesting approval for a Certificate of Convenience and Necessity ("CC&N") to provide Resold and Facilities-Based Long Distance Telecommunications Services.

Staff is recommending approval of the Application with conditions.

TMB:MAC:nr/ML

Originator: Matt Connolly

Attachment: Original and Thirteen copies

Arizona Corporation Commission

DOCKETED

FEB 02 2016

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DOCKET NO.: T-20946A-15-0384

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

X5 OPCO, LLC
DOCKET NO. T-20946A-15-0384

IN THE MATTER OF THE APPLICATION OF X5 OPCO LLC FOR A CERTIFICATE OF
CONVENIENCE & NECESSITY TO PROVIDE COMPETITIVE INTEREXCHANGE
TELECOMMUNICATIONS THROUGHOUT THE STATE OF ARIZONA

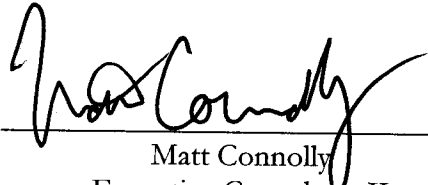
February 2, 2016

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STAFF ACKNOWLEDGMENT

The Staff Report for X5 OpCo, LLC, Docket No. T-20946A-15-0384 was the responsibility of the Staff member listed below. Matt Connolly was responsible for the review and analysis of the X5 OpCo, LLC Application for a Certificate of Convenience and Necessity to provide Resold and Facilities-Based Long Distance Telecommunications Services within the State of Arizona, in addition to the petition for a determination that its proposed services should be classified as competitive.



Matt Connolly
Executive Consultant II

1. INTRODUCTION

On November 9, 2015, X5 OpCo, LLC ("X5" or "Applicant") filed an Application for a Certificate of Convenience and Necessity ("CC&N") to provide resold and facilities-based interexchange telecommunications services within the State of Arizona. The Applicant also petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive.

On December 9, 2015, the Utilities Division of the Commission ("Staff") issued and docketed a Letter of Sufficiency in this matter, informing the Applicant its application met the sufficiency requirements under Arizona Administrative Code ("A.A.C.") R14-2-502. On January 4, 2016, X5 filed an Affidavit of Publication, certifying that the Applicant had published notice of its Application and the scheduled Hearing. On December 16, 2015, Staff issued its First Set of Data Requests to X5. Responses to Staff's First Set of Data Requests were received from the Applicant on January 6, 2016. On January 11, 2016, Staff issued its Second Set of Data Requests to X5. Responses to Staff's Second Set of Data Requests were received from the Applicant on January 19, 2016.

X5 filed this Application in conjunction with a Notification Regarding the Acquisition by X5 OpCo LLC of NovaTel Ltd., Inc. Assets ("NovaTel") dated November 9, 2015, in Docket Nos. T-20946A-15-0385 and T-20601A-15-0385. As part of this transaction, NovaTel's Arizona commercial interexchange customers will be transferred to X5. In order to effect the transaction, X5 is seeking telecommunications authority in Arizona to ensure the transfer of NovaTel customers occurs without issue.

Staff's review of this Application addresses the overall fitness of the Applicant to receive a CC&N. Staff's analysis also considers whether the Applicant's services should be classified as competitive and if the Applicant's initial rates are just and reasonable.

2. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

X5, formed on October 10, 2014, is a foreign limited liability corporation organized under the laws of the State of Delaware. X5 is a wholly owned subsidiary of X5 Holdings, LLC which, in turn, is majority owned and controlled by NewSpring Holdings LLC. X5's headquarters is located at 1008 Western Avenue, Suite 400, Seattle, Washington, 98104. X5 currently has authority to provide resold or facilities-based local exchange and/or interexchange services in fifteen (15) jurisdictions outside of Arizona (see Attachment A).¹

The officers and management team of X5 have just over a combined forty-seven (47) years experience in the telecommunications industry. X5 indicated senior management will be supported by a staff of trained and experienced telecommunications professionals, most of whom have served in their current roles in X5 Solutions, Inc., a telecommunications company whose assets were acquired by X5 in early 2015.²

¹ X5 response to Staff Data Request STF 1.4.

² X5 response to Staff Data Request STF 1.11.

X5 indicated it does not plan to have employees in Arizona.³ Customer complaints will be handled internally through the Applicant's customer service department. Customers may contact X5 using the toll free customer service number of 1-888-588-1501 or via the email address of support@x5solutions.com.⁴

X5 anticipates using switching equipment located out of state to route and complete inter- and intrastate long distance calls. It does not plan to have facilities located in Arizona and instead will lease transport facilities.⁵ X5 will be reselling the interexchange services of AT&T, Level 3 and Verizon Business.⁶

Based on the above information, Staff believes X5 possesses the technical capabilities to provide the services it is requesting the authority to provide in Arizona.

3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

X5 provided unaudited consolidated financial statements for year ending December 31, 2015. X5 also provided *pro forma* projected financial statements for 2016 which assumes the combined acquired assets of X5, NovaTel and Cornerstone Telephone Company (the latter two companies represent X5 acquisitions to be completed in 2016). The financial statements for year ending December 31, 2015, lists total assets of \$21,556,479.96; total equity of \$10,279,413.45 and net income of negative \$1,729,457.88. The financial statements for year ending December 31, 2016, lists total assets of \$69,490,000; total equity of \$24,662,000 and net income of \$1,824,000.

4. ESTABLISHING RATES AND CHARGES

The Applicant would initially be providing service in areas where an ILEC, along with various interexchange carriers ("IXC") are providing telephone service. Therefore, the Applicant would have to compete with those providers in order to obtain subscribers to its services. The Applicant would be a new entrant and would face competition from both an incumbent provider and other competitive providers in offering service to its potential customers. Therefore, the Applicant would generally not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

Both an initial rate (the actual rate to be charged) and a maximum rate must be listed for each competitive service offered, provided that the rate for the service is not less than X5's total service long-run incremental cost of providing the service pursuant to A.A.C. R14-2-1109.

X5 submitted its proposed Arizona Tariff No. 1 to support its Application. In this tariff, X5 adopted the Arizona tariffed rates of NovaTel.⁷ NovaTel's rates were approved by the Commission in Decision No. 71911, dated September 28, 2010. The rates proposed by this filing are for

³ X5 response to Staff Data Request STF 1.1.

⁴ X5 response to Staff Data Request STF 1.9.

⁵ X5 response to Staff Data Request STF 2.2.

⁶ X5 response to Staff Data Request STF 2.3.

⁷ X5 response to Staff Data Request STF 1.21.

competitive services. In general, rates for competitive services are not set according to rate of return regulation. The Applicant indicated that at the end of the first twelve months of operation the net book value of all Arizona assets that could be used in the provision of telecommunications service to Arizona customers will be \$0 as it will not maintain facilities or assets in Arizona.

The rate to be ultimately charged by the Applicant will be heavily influenced by the market. Therefore, while Staff considered the fair value rate base information submitted by the Applicant, the fair value rate base information provided should not be given substantial weight in this analysis.

5. REVIEW OF COMPLAINT INFORMATION

In its Application, the Applicant states that it has not had an Application for authority to provide service denied in any state or jurisdiction. The Applicant indicated that none of its officers, directors or partners have been or are currently involved in any civil or criminal investigation or been convicted of any criminal acts within the past ten (10) years.

X5 is currently authorized to provide telecommunications services in fifteen (15) jurisdictions (see Attachment A) and currently has an application pending to provide telecommunications services in nine (9) jurisdictions (see Attachment B). Staff contacted the Public Utility Commissions in seven (7) jurisdictions outside of Arizona in to determine if X5 is indeed certificated or registered to provide telecommunications services in the jurisdictions listed by the Applicant. Staff also inquired whether there were any consumer complaints filed against the Applicant. The information Staff obtained indicates that X5 is authorized to provide telecommunications services in the sampled states and no complaints have been filed.

The Consumer Services Section of the Utilities Division reports that there have been no complaints, inquiries, or opinions filed against X5 from January 1, 2012 to December 1, 2015. Consumer Services also reports that X5 is in Good Standing with the Corporations Division of the Commission. Further, a search of the FCC website found that there have been no complaints filed against X5.

6. COMPETITIVE SERVICES ANALYSIS

The Applicant has petitioned the Commission for a determination that the services it is seeking to provide should be classified as competitive.

6.1 *Competitive Services Analysis for Interexchange Services*

6.1.1 **A description of the general economic conditions that exist, which makes the relevant market for the service one that is competitive.**

The statewide interexchange market that the Applicant seeks to enter is one in which numerous facilities-based interexchange carriers and resellers of interexchange service have been authorized to provide service throughout the State. The market the Applicant seeks to enter is also served by wireless carriers and VoIP providers. The Applicant will be a new entrant in this market and, as such, will have to compete with those existing companies in order to obtain customers.

6.1.2 The number of alternative providers of the service.

There are a large number of facilities-based interexchange carriers and resellers providing interexchange service throughout the State. The market the Applicant seeks to enter is also served by wireless carriers and VoIP service providers.

6.1.3 The estimated market share held by each alternative provider of the service.

Facilities-based interexchange carriers, interexchange service resellers, independent ILECs, CLECs, wireless carriers and VoIP providers all hold a portion of the interexchange market.

6.1.4 The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications Applicant, as defined in A.A.C. R14-2-801.

X5 does not have any affiliates that are alternative providers of interexchange service in Arizona.

6.1.5 The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.

Both facilities-based interexchange carriers and interexchange service resellers have the ability to offer the same services that the Applicant has requested in their respective service territories. Similarly, many of the ILECs and CLECs offer similar interexchange services. The market the Applicant seeks to enter is also served by wireless carriers and VoIP service providers.

6.1.6 Other indicators of market power which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the service(s).

The interexchange service market is:

- a. One with numerous competitors and limited barriers to entry.
- b. One in which established interexchange carriers have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market.
- c. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.
- d. One in which the share of the market held by wireless carriers has increased over time, while that held by wireline carriers has declined.

7. RECOMMENDATIONS

The following sections contain Staff recommendations on the Application for a CC&N and the Applicant's petition for a Commission determination that its proposed services should be classified as competitive.

7.1 *Recommendations on the Application for a CC&N*

Staff recommends that Applicant's Application for a CC&N to provide intrastate telecommunications services, as listed in this Report, be approved. In addition, Staff further recommends:

1. That the Applicant comply with all Commission Rules, Orders and other requirements relevant to the provision of intrastate telecommunications services;
2. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
3. That the Applicant cooperate with Commission investigations including, but not limited to customer complaints;
4. The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. The Applicant indicated that at the end of the first twelve months of operation the net book value of all Arizona assets that could be used in the provision of telecommunications service to Arizona customers will be \$0. The rate to be ultimately charged by the Applicant will be heavily influenced by the market. Therefore, while Staff considered the fair value rate base information submitted by X5, the fair value information provided was not given substantial weight in this analysis.

Staff further recommends that the Applicant be ordered to comply with the following. If it does not do so, the Applicant's CC&N shall be null and void after due process.

1. The Applicant shall notify the Commission through a compliance filing within (30) thirty days of the commencement of service to its first end-user customer.
2. The Applicant shall docket conforming tariff pages for each service within its CC&N within 365 days from the date of an Order in this matter or 30 days prior to providing service to its first customer, whichever comes first.
3. The Applicant shall abide by the Commission adopted rules that address Universal Service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications service providers that interconnect into the public switched network shall provide funding for the Arizona Universal Service Fund ("AUSF"). The Applicant will make the necessary monthly payments required by A.A.C. R14-2-1204(B).

7.2 *Recommendation on the Applicant's Petition to have its Proposed Services Classified as Competitive*

Staff believes that the Applicant's proposed services should be classified as competitive. There are alternatives to the Applicant's services. The Applicant will have to convince customers to purchase its services, and the Applicant has no ability to adversely affect the local exchange or long distance service markets. Therefore, the Applicant currently has no market power in the local exchange service market where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.

Attachment A

The following are the jurisdictions in which X5 is currently authorized to provide the associated telecommunications services:

1. Florida - Interexchange
2. Iowa - Interexchange
3. Kentucky - Interexchange
4. Michigan - Interexchange
5. Minnesota - Interexchange
6. Missouri - Interexchange
7. New Jersey - Local Exchange and Interexchange
8. New York - Local Exchange and Interexchange
9. North Dakota - Interexchange
10. Ohio - Interexchange
11. Oregon - Local Exchange and Interexchange
12. Pennsylvania - Interexchange
13. Texas - Interexchange
14. Utah - Local Exchange and Interexchange
15. Washington - Local Exchange and Interexchange

Attachment B

The following are the jurisdictions in which X5 currently has an application pending for authorized to provide the associated telecommunications services:

1. Alabama - Interexchange
2. California - Interexchange
3. Illinois - Interexchange
4. Indiana - Interexchange
5. Kansas - Interexchange
6. Massachusetts - Interexchange and Local Exchange
7. New York - Local Exchange
8. Oklahoma - Interexchange
9. Pennsylvania - Local Exchange